

Is Europe Starting to Play by U.S. Rules?

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The recent assassination by a leftist terrorist group of an economic adviser to Italy's government on labor reforms, and the general strike called by Italian unions on this issue, show the deep emotion generated by these reforms. The unions and Prime Minister Silvio Berlusconi's conservative government and its supporters are locked in a bitter struggle over whether Italian labor markets will become less rigid. Europe's union leaders and employed workers, the so-called insiders, generally remain strongly opposed to changes making labor markets more flexible and their jobs less secure.

Until recent years, most Continental European politicians and intellectuals dismissed what they derisively called the British and American "Anglo-Saxon" model of competition and price flexibility. Yet a quiet but enormous change may be taking place in European attitudes toward competition in labor and other markets. This change was evident in the way the market-based model dominated the recent meeting in Barcelona of leaders of the European Union. Prime Ministers as far apart politically as Tony Blair of Britain, Jose Maria Aznar of Spain, Berlusconi, and German Chancellor Gerhard Schroder all agreed that Europe should try to become the world's most competitive economy during the next decade. The main opposition to the Anglo-Saxon model came from France, as both President Jacques Chirac, a conservative, and Socialist Prime Minister Lionel Jospin objected to many proposed changes.

The reformers were reacting to the poor economic performance of Europe during the 1990s. Unemployment averaged well over 9% among the Continental members of the EU in the '90s, compared with 5 1/2% in the U.S. and similar low levels in Britain. Private employment expanded much more slowly in Europe, and, since 1995, labor productivity grew almost twice as rapidly in the U.S. as in Continental Europe.

I believe the French will also come around to the new European view of competition and market flexibility. I base this optimism on the reactions over time to an article I published in 1996 in the left-leaning French newspaper Le Monde. The article argued that the European pattern of high unemployment rates, long average duration of unemployment, early retirement of older workers, and very slow growth in employment are not inevitable to modern economies. They were instead the result of high social security and other labor taxes, laws that make it difficult to lay off employees, generous payments to the unemployed, and, in France, high minimum-wage laws. I advocated easing the cost to companies when they hire and fire workers, lowering labor taxes, lowering minimum wages, and raising retirement ages.

At the time, the article elicited replies from intellectuals and older economists who defended the European statist approach to labor markets. However, after five additional years of sluggish labor markets, European public opinion has shifted toward greater support of radical labor market reform. Now, younger economists in France--and elsewhere in Europe--agree that Europe needs drastic reforms.

To get around its restrictive labor laws, Spain has significantly extended the number of workers who could be on temporary contracts. The Netherlands began to encourage part-time work and greater flexibility in wages and hiring and firing decisions. The Barcelona summit resolved to liberalize labor markets elsewhere through lower labor taxes and reduced benefits to the unemployed. It also supported moves that would extend the average age of retirement by five years, to 63.

The Barcelona summit took concrete actions to deregulate other markets and promote greater competition in them. By the year 2004, all businesses will be free to choose their gas and electricity suppliers, and households will be able to do so by 2005. In a couple of years, Europe's electricity markets will be freer than the U.S.'s, unless the federal and state governments move more quickly toward deregulation. However, as I lamented in my Mar. 18 BusinessWeek column, the Enron Corp. scandal is curtailing America's electricity deregulation but apparently not Europe's desire to take advantage of new technologies that allow greater competition in this market.

Barcelona also adopted several directives that would further increase competition in financial markets, with the goal of full integration across the EU. Even prior to this summit, Europe had taken steps toward cross-border competition among commercial and investment banks.

Europe's domestic and foreign policies often appear to be defined mainly by differing with the U.S. But a few farsighted leaders have grasped that Europe's economy is too inflexible, and its regulations too inhospitable to competition and entrepreneurship. If these leaders have their way, Europe's economy may overtake the U.S.'s by adopting policies shunned and even ridiculed until only a few years ago.